

No. 11397.

IN THE

United States Circuit Court of Appeals
FOR THE NINTH CIRCUIT

In the Matter of

ABBOT KINNEY COMPANY,

Alleged Bankrupt.

E. A. GERETY, WILLIAM HARRAH, CHARLES BROWN and
HAROLD POOL,

Appellants,

vs.

ABBOT KINNEY COMPANY,

Appellee.

APPELLANTS' REPLY BRIEF.

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APPELLANTS' REPLY BRIEF.

Statement Re Questions and Points Involved in
Appellants' Opening Brief (pp. 2-3).

Appellants, in their Opening Brief, in addition to other questions, asked these jurisdictional questions:

1. Can three bond holders, whose claims are *secured* and who do *not waive their security*, file an involuntary petition in bankruptcy?
2. Where three such bond holders file a *defective* involuntary petition in bankruptcy, can the alleged bankrupt institute proceedings (Order to Show Cause) *prior to adjudication* to determine the validity of a conditional sales contract and to establish a trust in respect thereto over objection to jurisdiction by the holder of the contract?

3. Where, in connection with such petition, there is a stipulation of the parties to first determine the questions whether the petition is *sufficient and whether the alleged bankrupt is bankrupt* and the stipulation is approved by the Court, can the Court or any of the parties *repudiate the stipulation* over the objection of the other parties and proceed to try *title matters prior to the determination of said questions and prior to adjudication?*
4. Can the decision in an Order to Show Cause Proceeding, instituted under a *defective involuntary petition, prior to adjudication,* stand after the involuntary petition is dismissed?
5. On page 9 of Appellants' Brief the following *jurisdictional points* were stated:
 1. The District Court had *no jurisdiction* to entertain the Summary Proceedings resulting in the Order appealed from.
 2. *No persons qualified* to file an involuntary proceeding signed or joined in the involuntary petition.
 3. The involuntary petition *does not state an act of bankruptcy.*
 4. The alleged bankrupt cannot institute proceedings to recover a preference and to *quiet title and to establish a trust* against an adverse claimant *prior to adjudication.*
 5. Where the parties stipulated to a procedure to be followed and the Referee approved that stipulation, it is error to permit a repudiation of the stipulation.

6. Where involuntary petition was dismissed, it was error not to dismiss summary proceedings instituted by the alleged bankrupt.

Appellee in its reply avoid directly answering those questions and those points, and the authorities in support thereof, and with the exception of one case cited by Appellants *re* jurisdiction, Appellee does not comment one way or the other upon the numerous authorities referred to in Appellants' Brief and it is our contention that those authorities are controlling. These questions will be discussed *infra*.

Reply to Appellee's Statement of Facts.

With reference to the facts, Appellee says that Appellants' statement of facts are inadequate and incomplete and then proceeds to restate the facts by adding thereto and interpolating therein its own conclusions and various matters of argument. Furthermore, Appellee's statement of facts, commencing on page 2 of its Brief and extending to page 19 thereof, contains many inaccurate and misleading statements. On the contrary, the statement of facts set forth in Appellant's Brief was limited to a brief and concise statement of the material facts involved in this case and Appellants contend that the material facts are as set forth in Appellants' Opening Brief.

In view of our belief that we have set forth a fair statement of the material facts in our opening brief, we shall not take up in detail all of the various alleged statements of fact contained in the Appellee's Brief, but will limit our remarks in this respect to some of the inaccurate and misleading statements made by the Appellee and to some of their conclusions and argumentative matters contained under their heading "Statement of Case."

For instance, the first sentence of the second paragraph on page 4 of Appellee's Brief is not sustained by page 521 of the record as therein indicated. In that respect, it should be observed also that if that alleged statement were true, the directors, other than John Harrah and Carleton Kinney, would undoubtedly have immediately arranged a directors meeting and removed the Executive Committee.

The statement at the bottom of page 4 of Appellee's Brief to the effect that John Harrah and Carleton Kinney refused to attend a meeting so that a quorum would not be present, is not accurate. The record shows, on the contrary, that they didn't attend a meeting at the time because it was their desire to have a full board present.

The statements on page 5 of Appellee's Brief that the Cruickshank Company had renewed the \$10,000.00 offer in 1944 is not correct. M. Philip Davis and his associates had been trying to buy the contract and, in the year 1943, had an option to buy it, but did not disclose that fact or bring the same to the attention of the Abbot Kinney Company until the very day the option was expiring. [R. 312, 321, 497.] Appellants pointed out in their Opening Brief, and here repeat, that from the testimony of Hugh Darling, Appellee's own witness, who was in a position to know, it appears that there was no offer by the Cruickshank Company in 1944 to sell the contract to anyone for \$10,000.00 and that that company never at any time offered to sell the contract to the Abbot Kinney Company for \$10,000.00.

Page 325 of the record does not sustain the statement that John Harrah again rejected the offer of Cruickshank Company to sell the contract for \$10,000.00. It does not appear on page 325, however, that John Harrah then ad-

vised Brown and Gerety not to buy the contract. [R. 325.]

The references on page 5 of Appellee's Brief to a *renewed offer* to sell a contract to Abbot Kinney Company for \$10,000.00 are misleading. There was no such thing at that time. In fact, the Cruickshank Company never offered it to the Abbot Kinney Company for that price, although in 1943 M. Philip Davis had an option to buy it at that price. According to Mr. Newton, he had told John Harrah at one time that it could be bought for \$10,000.00, but at that time the company did not have the money. [R. 312, 323.]

The statements near the top of page 10 of Appellee's Brief to the effect that Gerety had general unlimited powers is not sustained by the record. On the contrary, Gerety's powers and duties were of a *limited character*. He was *manager in name only*. [R. 433-446, incl.]

The statement that Brown co-mingled William Harrah's supplies with his own is an inaccurate statement. Mr. Brown did buy some merchandise for Mr. Harrah, and Mr. Brown, as was customary among the various operators on the pier, did buy or borrow merchandise from, and sell or lend merchandise to, the other operators on the pier, including Mr. William Harrah. [R. 216 and 217.]

The statement at the top of page 13 of Appellee's Brief to the effect that Gerety was in full charge of the Abbot Kinney Company's affairs is based upon the conclusion of one witness and is contrary to the facts in that respect, as set forth in the record.

The matters contained in the last paragraph on page 13 of Appellee's Brief and most of the matters set forth on page 14 thereof, are not statements of fact, but statements of Appellee's theories and argument to justify the

improper use of bankruptcy jurisdiction to try title to personal property. In substance Appellee states there that Abbot Kinney Company was either insolvent or not insolvent, depending upon whether the sprinkler contract and the \$30,000.00 paid on it belonged to the Abbot Kinney Company. Appellee argues, therefore, to determine that question a petition in involuntary bankruptcy was filed alleging that Abbot Kinney Company was insolvent so that Appellee could try title to the sprinkler contract and the \$30,000.00 to find out whether or not the company was insolvent. Then if it was determined that the sprinkler contract and the \$30,000.00 belonged to the Abbot Kinney Company, the result would be that that company was not insolvent and not bankrupt and that it did not belong before the Bankruptcy Court. Yet Appellee's want the decision respecting the title to that property, which was determined under an order to show cause, to stand even though the bankruptcy petition is found invalid and is dismissed.

Appellants contend that Appellee's aforesaid argument supports our position that there was no jurisdiction to entertain such proceedings. Furthermore, we say that the matters contained in the foregoing paragraph are argumentative and are not properly included in a statement of facts.

There are numerous other conclusions and argumentative matters contained in the alleged statement of facts set forth in the Appellee's Brief, but we believe the foregoing are sufficient to illustrate our position in that regard. Suffice it to say that the statement of facts contained in Appellants' Opening Brief is, in our opinion, an accurate and complete statement of the material facts involved in this proceeding.

Reply to Appellee's Argument re Jurisdiction.

Appellants insist that the three *secured* bondholders, who did *not waive their security*, were not qualified to file such petition. That is shown on the face of the petition. Furthermore, the petition does not show an Act of Bankruptcy. The Bankruptcy Court never acquired jurisdiction and Appellants consistently and constantly objected to the proceedings because the Court had no jurisdiction to entertain the same. Appellee, contrary to the solemn and binding stipulation of the parties, approved by the Court, disregarded and repudiated that stipulation and caused *title to personal property to be tried prior to adjudication* under a defective petition which was subsequently dismissed. Appellants contend there was no jurisdiction to support such proceedings and that the same should not be tolerated.

In an effort to get around the lack of jurisdiction, Appellee contends that the amended involuntary petition invoked the jurisdiction of the Court simply because, according to them, it contains an allegation "that Abbot Kinney Company was insolvent" and an allegation "that each of the three petitioning creditors had a provable general unsecured claim against the corporation, fixed as to liability and liquidated in amount, which in the aggregate amounted to more than \$500.00 over and above the value of securities held by them." (App. Br. p. 20.) If the involuntary petition had stopped at that point, their position might have some merit, but then the question would probably have been disposed of by an indictment for perjury. However, Appellee's petition did not stop there. It contained further allegations. The petitioning creditors proceeded to state the nature and amount of their

claims. [See R. 6, par. 5.] The petition alleged the giving of a trust indenture and the amount of the outstanding bonds, the value of assets, that the petitioners were bondholders, and that they "*do not waive the security for said bonds.*" The first above mentioned allegations are naked *conclusions* of the pleader. *The ultimate facts are alleged in paragraph 5*, and it is clear from the petition that the outstanding bonds amount to \$269,000.00 which are *secured* by property of the value of \$400,000.00, and that the bonds bear interest at the rate of 7% per annum (which would amount to \$18,830.00 per year), and that there is due in interest upon said bonds \$225,000.00. This interest obligation is not alleged to be owing, but merely due, under Section 336a, C. C. P. (App. Op. Br. p. 3.) The statute of limitations would be the period of six years. It is clear, therefore, that we have petitioning creditors whose claims *were secured* by security equaling the value of the outstanding bonds. How then can it be said that these claims were *fixed as to liability and liquidated in amount* as required by Section 59b of the Bankruptcy Act? We again repeat that the *petition on its face was defective and showed want of jurisdiction.*

Appellee argues, however, that regardless of the defects of the involuntary petition, the lower court acquired jurisdiction by the filing of the defective petition and the service of a subpoena and that no person other than the alleged bankrupt could suggest to the lower court its jurisdiction had been improperly invoked and that it was proceeding contrary to law. (App. Br. p. 27.) How could the Court acquire *jurisdiction* under a petition which showed *want of jurisdiction on its face?*

Appellee's said argument, in an effort to show jurisdiction, is best answered by the case of *Taft v. Century Savings*, 141 Fed. 369, 15 A. B. R. 597, and the Supreme Court cases quoted from therein. The Court there said:

“The District Court, as a court of bankruptcy, is undoubtedly a court of *limited jurisdiction*. Congress alone had power to determine the subjects over which it might exercise jurisdiction. As said by the Supreme court in *Johnson Company v. Wharton*, 152 U. S. 252, 260, 38 L. ed. 429, 433, 14 Sup. Ct. Rep. 608:

‘The distribution of the judicial power of the United States among the courts of the United States is a matter entirely within the control of the legislative branch of the government.’

It is suggested that the bankruptcy court had jurisdiction over the alleged bankrupt in this case by due service of the subpoena upon him, and over the subject matter by virtue of the Bankruptcy Act which confers upon it plenary jurisdiction in bankruptcy proceedings. But this does not solve the question. It was said by the Supreme Court in *Windsor v. McVeigh*, 93 U. S. 274, 282, 23 L. ed. 914, 917, that: ‘All courts, even the highest, are more or less limited in their jurisdiction. They are limited to particular classes of actions. . . . Though the court may possess jurisdiction of a cause, of the subject matter and of the parties, it is still limited in its modes of procedure, and in the extent and character of its judgments. It must act judicially in all things, and cannot then transcend the power conferred by the law. . . . The judgments mentioned . . . (in the case referred to for illustration) would not be

merely erroneous. They would be absolutely void, because the court in rendering them would transcend the limits of its authority in those cases.'

To the same effect are the following cases:

Ex parte Lange, 18 Wall. 163, 176, 21 L. ed. 872, 878; *Cornett v. Williams*, 20 Wall. 226, 250, 22 L. ed. 254, 259. In the last-cited case, it is said:

'The settled rule of law is that, jurisdiction having attached in the original case, everything done within the power of that jurisdiction, when collaterally questioned, is to be held conclusive of the rights of the parties, unless impeached for fraud.'

Applying the foregoing principles to the statute under consideration, it appears that Congress limited the jurisdiction of the District Court as a court of bankruptcy to cases in which the debtor owes at least \$1,000. Cases in which the debtor owes less than that sum are not brought 'within the power' of its jurisdiction, and debtors owing less than that sum are not subject to the provisions of the Bankruptcy Act. It has been held by the Circuit Court of Appeals for the Seventh Circuit that a petition in involuntary bankruptcy must show clearly that the debtor is not a wage earner or engaged chiefly in farming or the tillage of the soil. *In re Taylor*, 4 A. B. R. 515, 102 Fed. 728, 2 N. B. N. Rep. 929. To the same effect is the decision of this court in *In re Plymouth Cordage Company*, 13 A. B. R. 665, 135 Fed. 1000, and the decision of the Circuit Court of Appeals of the Fifth Circuit in *Beach v. Macon Grocery Company*, 9 A. B. R. 762, 120 Fed. 736. We observe no difference in principle between the omission of an averment bringing the debtor without the exception as to wage earners or persons engaged

chiefly in farming or the tillage of the soil and the omission of an averment bringing the debtor within the class which owes debts to the amount of \$1,000 or over. *These provisions are both, in our opinion, jurisdictional*, and either of the omissions just mentioned shows that the debtor proceeded against is not within the class of persons subject to the provisions of the Bankruptcy Act, or subject to the jurisdiction of the court in bankruptcy. *The petition in this case was therefore defective in not disclosing that the debtor owed at least \$1,000, and for that reason it conferred no jurisdiction upon the court to subject Cohen, the debtor, to the provisions of the Act.*" (Italics ours.)

To confer jurisdiction Section 59-b of the Bankruptcy Act requires *three creditors "who have provable claims fixed as to liability and liquidated as to amount."* This is as essential as the provisions of Section 4 requiring debts of \$1,000 or more. (Italics ours.)

Appellee cites the case of *In re S. W. Straus & Co., Inc.*, 67 F. (2d) 605, where the parties raising the defect were estopped to do so by their conduct in filing an answer and going to trial. In the case at bar *the defective petition and the lack of jurisdiction of the lower court were urged at the commencement of, and throughout, the proceedings.* [See R. 42, 43, 145, 202; also R. 145 to 148.] Appellee next cites *In re Hudson Coal Co., Debtor*, 22 Fed. Supp. 768. The case arose under 77-b which permitted the court to affect the security of bondholders, which made the bondholders parties in interest and permitted them to intervene to be heard in connection with their affected rights. It certainly does not permit bondholders to institute proceedings on their behalf without

the trustee and other bondholders by parties thereto contrary to a specific provision of the trust indenture. [R. 585, Op. Br. p. 13.] For a discussion of the history and objects of 77-b, see *Chicago Title & Trust Co. v. Wilcox Building Corporation*, 302 U. S. 120, 82 L. Ed. 147.

Appellee next cites *In re Plymouth Cordage Co.*, 135 Fed. 1000, and *In re First National Bank of Belle Fourche*, 152 Fed. 64. Remington, Vol. 1, p. 72, in discussing the last case, points out the correct rule:

“The argument of these last two cases is that such facts pertain, not to the subject matter, but simply to the cause of action. However, it would seem that did they pertain simply to the cause of action their nonexistence would be waivable; but, assuredly, neither consent nor waiver can confer jurisdiction in the bankruptcy court of one district to adjudge bankrupt a debtor not resident domiciled nor having his principal place of business therein, although the ascertainment of such jurisdictional fact must be left to the same court for determination and its determination may not be subject to collateral attack. Nor would any attempt to administer in bankruptcy a banking corporation or other corporation not included within the designated classes subject to bankruptcy be otherwise than null and void. Such ruling is familiar in probate jurisprudence upon the subject of attempts to administer upon the estate of a decedent who was not a resident at the time of his death or otherwise within the statutory classification.

“The ruling that the *fact* of occupation is not jurisdictional is purely obiter in each of these cases; and the ruling that the *allegation* of occupation also is not jurisdictional, evidently has reference to the unimpeachability of the record by collateral attack

where the record does not *affirmatively* show the debtor does *not* belong to the particular class but simply omits all allegations whatsoever as to the occupation. As is later noted (§§511, 535), the record of adjudication imports jurisdiction where jurisdictional findings are merely omitted and makes the adjudication impervious to collateral attack, but if the record of adjudication affirmatively shows the debtor did *not* belong to one of the classes subject to bankruptcy it would without question be absolutely void on its face. Section 2 of the Act grants 'jurisdiction' to adjudge bankrupt debtors who have resided or had their domicile or place of business within the district a certain specified time. Such residence, domiciliation, etc., are, therefore, declared to be jurisdictional. Of the same nature are the limitations regarding occupation and amount of debts; they are limitations upon or extensions of the general subject matter of 'bankruptcies'."

It is clear from the above authorities, as well as those set forth in Appellants' Opening Brief, that a Bankruptcy Court is one of *limited jurisdiction* and that one must bring himself within the statute to confer jurisdiction; also that if there is no jurisdiction the proceedings are *absolutely void*. It is just as essential that there be three qualified unsecured creditors in an involuntary petition as it is to have a resident debtor as prescribed by the Act. In the case at bar the petition shows on its face that the petitioning creditors were *not qualified* and that no Act of Bankruptcy had been committed. This petition was later dismissed and there *never was any adjudication*. Appellants maintain that on the facts and under the law there was *no jurisdiction* and all of the proceedings including the order appealed from were and are *void*.

Reply to Appellee's Argument Re Propriety of Summary Proceedings.

Appellee's argument on the above point, commencing on page 28 of its Brief, is based upon the premise that the Bankruptcy Court had possession of all of the property of the alleged bankrupt and could determine all of the issues involved in these proceedings. Appellee relies upon the case of *Murphy v. Hoffman*, 211 U. S. 562. We pause to ask this Honorable Court to observe that the Bankruptcy Court in that case was in the *actual possession* of the property which was subject to the litigation. The Court said: "Where a court of competent jurisdiction has taken property into its possession, through its officers, the property is thereby withdrawn from the jurisdiction of all other courts." The same situation existed in *Isaacs v. Hobbs*. The same principle is announced in the next case cited by Appellee, *In re Baldwin*, 291 U. S. 610, except that there is added the feature that title passes to the trustee as of the date of the filing of the petition. This passing of title from the bankrupt to the Court occurs upon an adjudication but relates back to the filing of the petition. (See Section 7-2 11 U. S. C. A. 110; *Johnson v. Collier*, 222 U. S. 538, at 539 and 540; *Taylor v. Sternberger*, 293 U. S. 470, 79 L. Ed. 599, 55 S. Ct. 260.)

No receiver was appointed upon the filing of the involuntary petition in case at bar and the ABBOT KINNEY COMPANY came to Court, and was at all times, still in possession of the sprinkler system. [See Petition for Order to Show Cause, R. 17, par. 2; R. 23, pars. 1, 2 and 3.] Furthermore, that company ever since has been and

still is in possession of the sprinkler system, free of any bankruptcy proceeding.

A reply to Paragraph 3 further enlarges upon this question of jurisdiction and passing of title. We think the right to protect property that may come into the possession of the Bankruptcy Court by *injunction* is clearly distinguishable from directing a proceeding against an adverse claimant where *no statutory jurisdiction is conferred* upon the District Court *prior to the adjudication* and the appointment of a trustee.

Appellants contend that there is no merit in Appellee's argument on the foregoing point. In this case, we had a *defective* involuntary petition. The three alleged creditors who signed the same were not unsecured creditors and were not qualified petitioners, but on the contrary, they were, as shown on the face of the petition, *secured creditors*. There never was any adjudication. The defective involuntary petition was subsequently dismissed. There was nothing in the possession of the Court which could be construed in any sense to confer jurisdiction under the circumstances. It is true that the parties had deposited the money with the clerk but that was done *conditionally* under the terms of the above mentioned stipulation and under any arrangement whereby the parties agreed to first determine whether or not this matter had any business being in the Bankruptcy Court. In other words, to first determine whether or not the involuntary petition was sufficient and whether the ABBOT KINNEY COMPANY could be adjudicated bankrupt. It was further the understanding of the parties in good faith that the money would be refunded to the depositors pursuant to the stipulation if there was no adjudication.

Reply to Appellee's Argument That the Alleged Bankrupt Could Institute These Proceedings.

In considering this question it is important to define the property rights in respect to the subject matter of the proceedings had in the lower Court and have clearly in mind *where title was vested*. It is further necessary that an action be prosecuted by the real party in interest *in a Court that has the statutory jurisdiction* to entertain the proceeding in accordance with the procedure required by statute.

What is the situation in the case at bar? At the time of the filing of an involuntary petition the alleged cause of action against the Appellants herein was vested in the ABBOT KINNEY COMPANY. That company would have had to commence an action in the *State Court* in order to obtain the relief sought by the Petition for Order to Show Cause. [R. 17.] The passing of the title to that cause of action *would not change until an order of adjudication has been entered and a trustee in bankruptcy appointed*. *Taylor v. Sternberger*, 293 U. S. 470, 55 S. Ct. 260; Section 70(a) of the Bankruptcy Act, 11 U. S. C. A. 110:

“The trustee of the estate of a bankrupt and his successor or successors, if any, upon his or their appointment and qualification, shall in turn be vested by operation of law with the title of the bankrupt as of the date of the filing of the petition in bankruptcy.”

As pointed out in Remington, Vol. 3, Sec. 1187, it is important to distinguish whether the title comes to the

trustee from the bankrupt under clause 3 of Sec. 70 or from creditors under clauses 4 and 5 of said section.

“Rights of creditors which may be enforced by the trustee by virtue of § 70(e), 11 U. S. C. A. §110(e), must be distinguished from those which he derives from the bankrupt by virtue of clause (3). The latter rights can only be enforced in courts in which the bankrupt could have enforced them. This follows from the limitations contained in §23, 11 U. S. C. A. §46. In Massachusetts, the rights of a husband in the property of his wife do not pass to a trustee in bankruptcy. The right is certainly not a power within the meaning of clause (3). The power of a licensee to assign his license has been regarded as within clause (3). The right of a corporation to void contracts entered into by directors who are acting in breach of their fiduciary responsibility passes to the trustee by virtue of clause (3). Clause (3) was applied where a managing agent of a corporation, having power to borrow, but no power to mortgage assets of his principal to secure moneys borrowed, gave a mortgage for that purpose, and thereafter the corporation was adjudicated. It was held that the right which the bankrupt corporation might have exercised for its own benefit to repudiate the mortgage could be exercised by its trustee. The trustee, in the right of the bankrupt, under clause (3), may recover assets diverted by a director of the bankrupt corporation who has taken advantage of his fiduciary position.”

(See Remington, Vol. 3, 1206.01, p. 81):

“The right of a corporation, and therefore of its trustee, to recover from officers and directors for breach of their fiduciary duty may arise at common law and not by reason of any express provision of

the corporation statutes, and it passes to the trustee. The trustee, in seeking to recover from directors for fraud and mismanagement, must establish something more than mere neglect. Where a trustee seeks to recover funds wrongfully diverted by directors prior to bankruptcy, he must show that there were creditors existing at the time of the wrongful withdrawal."

The Supreme Court has considered this question in *Kelley v. Gill*, 245 U. S. 116, 62 L. Ed. 185, 38 S. Ct. 38:

"The question presented is of importance in the administration of bankrupt corporations. To enable the trustee, by means of a single suit in the court of bankruptcy, to determine and enforce payment of all amounts due from stockholders, would obviously promote the effective administration of the bankrupt estate; but the aggregate burden thereby cast upon the individual stockholders might be correspondingly heavy. Whether the right to choose the court and the place in which litigation shall proceed should be conferred upon the trustee or upon the defendant is a legislative question with which Congress has dealt in the Bankruptcy Act (1898, chap. 541, 30 Stat. at L. 544). Section 2, clause 7, confers upon the court of bankruptcy jurisdiction to 'cause the estates of bankrupts to be collected, reduced to money and distributed, and determine controversies in relation thereto except as herein otherwise provided.' But § 23-b prohibits the trustee (with exceptions not here applicable) from prosecuting, without the consent of the proposed defendant, a suit in a court other than that in which the bankrupt might have brought it, had bankruptcy not intervened. The corporation is a citizen of California. It could not have sued these stockholders except in the state courts. The

court of bankruptcy was, therefore, without jurisdiction of this suit unless there is something either in the nature of the cause of action, or in the relation of stockholders to a corporation, or in the character of the suit, which prevents the application of the prohibition contained in § 23-b.

“But even if there had been equity jurisdiction, the suit could not have been brought in the Federal court. The cause of action sued on would still have been the broken promise of the individual stockholder to pay the balance on his stock. That was a cause of action on which the bankrupt could have sued and sued only in the state court. The cause of action would remain the same, although equity, to avoid multiplicity of actions at law, undertook to deal with three thousand separate claims in a single suit. The mere fact that the bankrupt could not have brought the particular suit would not confer on the court of bankruptcy jurisdiction of the suit of the trustee. Bardes v. First Nat. Bank, 178 U. S. 524, 44 L. ed. 1175, 20 S. Ct. 1000, 4 A. B. R. 163.”

Section 23-b of the Bankruptcy Act, quoted on page 19 of our Opening Brief, *prevented the alleged bankrupt from litigating this in the bankruptcy court.* Counsel’s contention that the filing of the petition withdrew the jurisdiction of all other courts is contrary to said Section 23-b, and his cases in argument in this connection are wholly inconsistent with his argument under his Point 2. We do not contend, as stated by counsel (App. Br. p. 32), for a rule denying the bankrupt the right to litigate over assets prior to an adjudication, but for a rule that *such litigation must be in the court and forum where the bankrupt would have had to litigate the question if an involuntary petition had not been filed.* (See Collier on Bankruptcy, 14th Edition, Vol. 1, p. 1176.)

Answer to Appellee's Argument re Rights of Creditor to Intervene.

Appellee argues that in 1938 an amendment to the Chandler Act with respect to Section 18-b deprived creditors of the right to move to dismiss an involuntary petition defective in form and imposing upon the jurisdiction of the District Court. This objection on behalf of creditors is to be distinguished from the procedure of answering and participating in a trial of the issues which are to be determined on evidentiary matters. In fact it is the *duty of the court to raise the question* of lack of jurisdiction where the parties fail so to do. The authorities are collected in the case of *In re Pacific States Savings & Loan*, 27 Fed. Supp. 1009, at 1012. Remington states the rule in Volume 1, Sec. 35, p. 71: "Thus, the question may be raised by creditors or others, even though the bankrupt waives, consents or absconds." (See *In re New York Tunnel Co.*, 166 Fed. 284, 21 A. B. R. 531):

"Although we think these objections are good, still if the appellants and petitioners have called our attention to a *jurisdictional defect* which makes the adjudication a nullity, we feel bound to consider it. *If a petition for adjudication were made by only two creditors, the law requiring three, there would be a jurisdictional defect on the face of the record, making any adjudication void.* On the other hand, if the aggregate amount of claims were stated to be \$500 as required by law, and because of set offs or other reasons was in point of fact less, an adjudication would be an error to be corrected by appeal. So if the petition were against a railroad company there would be on the fact of the record such a jurisdictional defect as would make an adjudication

void. Whereas, if the corporation might or might not be considered within the act an adjudication, even if erroneous, would have to be corrected by appeal."

(Italics ours.)

Answer to Appellee's Argument re Repudiation of Stipulation.

We think the stipulation itself is the best reply to Appellee's argument with reference to the above point for the reason that the stipulation was approved by the Court and provided for an *immediate determination of the involuntary proceeding*, and when the same was determined, the party to whom said funds should be paid. It is the disregard of that stipulation by the Court and the parties and the attempt to proceed under the cases cited in Appellee's Brief that constitute the repudiation and the substitution of litigation in the place of an approved agreement.

The specific intent and purpose of the stipulated arrangement was to *hold everything in abeyance* until it was decided whether or not any of these matters belonged in the Bankruptcy Court. The idea was that it should first be determined whether the petition was of any effect and whether there could be an adjudication. Furthermore, the specific intent and purpose was to do nothing until, if and after there had been an *adjudication*. Appellants contend that the course taken by Appellee is not only contrary to the stipulation and its specific intent and purpose, but that the same amounts to an imposition on the Bankruptcy Court. We contend that there was no justification for Appellee's conduct in that regard and that there was no jurisdiction on the part of the Court to tolerate those proceedings.

Answer to Appellee's Argument re Effect on Proceedings by Dismissal.

Appellee's argument with reference to this point is based upon the District Judge's decision which, in turn, cites *Isaacs v. Hobbs*, 282 U. S. 734. This argument is predicated upon the unsound premise that title to the bankrupt's assets passed to the Bankruptcy Court. As we have heretofore pointed out in reply to Appellee's Point 3, *title does not pass until there has been an adjudication and the appointment and qualification of a trustee*. This is clearly laid down by the Supreme Court in *Johnson v. Collier*, 222 U. S. 538, at 540, where the rule is stated as follows:

“While for many purposes the filing of the petition operates in the nature of an attachment upon choses in action and other property of the bankrupt, yet his title is not thereby divested. *He is still the owner, though holding in trust until the appointment and qualification of the trustee, who thereupon becomes ‘vested by operation of law with the title of the bankrupt’ as of the date of adjudication.*

“Until such election the bankrupt has title-defeasible, but sufficient to authorize the institution and maintenance of a suit on any cause of action otherwise possessed by him. It is to the interest of all concerned that this should be so. There must always some time elapse between the filing of the petition and the meeting of the creditors. During that period it may frequently be important that action should be commenced, attachments and garnishments issued, and proceedings taken to recover what would be lost if it were necessary to wait until the trustee was elected.” (Italics ours.)

If an injunction had been issued by the Bankruptcy Court when the proceedings were dismissed, the effect of the injunction would likewise fall as the same is ancillary to the main action itself.

The United States Supreme Court has definitely stated the rule that is applicable in such matters. In *Acme Harvester Co. v. Beekman Lumber Co.*, 222 U. S. 300, 32 Supreme Court R. 96, 100, that Court said:

"It was the duty of the bankruptcy court, if it intended to administer the property under the bankruptcy law, to *promptly determine the question of adjudication*, to proceed with the selection of a trustee the administration and distribution of the estate, as required by the act. This it evidently declined to do, and permitted the creditors' committee, which had been organized for the avowed purpose of defeating court proceedings, to administer the estate, to buy and sell property, and mature a plan for the reorganization of the concern. This may have been for the benefit of the creditors, but it was not the administration of the law as laid down in the bankruptcy act. *It is not within the province of the bankruptcy court to deny an adjudication in bankruptcy, and then hold jurisdiction over the property* for the purpose of allowing some of the creditors to effect a reorganization and distribution of the property.

We cannot say that the supreme court of Missouri was wrong; indeed, we think it was right in reaching the conclusion that the district court had declined to adjudicate the corporation a bankrupt and vest its property in a trustee, and, deeming it best for the creditors to follow out their plans, had found that the case was not one calling for the in-

tervention of the bankruptcy court. Indeed, there is nothing in the record to contradict the statement of the circular in evidence in the court below, that the court had found the corporation solvent. *With the question of adjudication determined against the right to proceed in bankruptcy, the jurisdiction of the district court ended, and the property became subject to the ordinary methods of procedure in courts of competent jurisdiction.*" (Italics ours.)

Appellants contend that the petition was defective on its face; that the alleged petitioning creditors were not qualified to file the same, and that it was certain that the involuntary petition would ultimately be dismissed. Appellants contend that there was no jurisdiction under the circumstances to try the matters resulting in the order appealed from. Appellants further contend that the dismissal of the involuntary petition should and did have the effect of eliminating everything that was done under the defective involuntary petition.

Reply to Appellee's Argument re Fiduciary Relationship.

In paragraphs VII and VIII of Appellee's Brief (pp. 43-59) Appellee, without answering the facts or law as set forth in Appellants' Brief, attempts to show a conspiracy existed between JOHN HARRAH, GERETY and BROWN and after arriving at such a conclusion, cite cases relative to conspiracy with which Appelants have no quarrel, provided that law is read in the light of the facts to which it is applicable.

Nowhere in the evidence is there any showing that BROWN was an undisclosed agent for JOHN and WILLIAM

HARRAH in connection with the purchase of the sprinkler contract. The facts merely show that BROWN and GERETY purchased the contract and that thereafter WILLIAM HARRAH acquired an interest in the contract. The argument on page 45 of the Appellee's Brief that JOHN HARRAH was the motivating force behind the purchase of the contract is not sustained by the record. Furthermore, fair consideration of the matter precludes that conclusion because if JOHN HARRAH had desired to buy the contract, he certainly would not have allowed BROWN and GERETY to purchase the same, nor would he have permitted Brown's interest to be purchased with his (JOHN HARRAH'S) money, and GERETY's interest with his (GERETY'S) money. The authorities cited by Appellee on pages 46 and 47 of their Brief are the law in California relative to proving conspiracy, but Appellee has failed to show (1) That Gerety had any fiduciary relationship as the same is defined by law; (2) that Gerety violated any fiduciary relationship. In spite of the conclusions reached by the Appellee, there has been no showing in this case that either of the Harrahs acquired any interest in the sprinkler contract until after the purchase of the same. There is an attempt by Appellee to show a violation of some fiduciary relationship on the part of Gerety based on the conversation supposedly held with Al Newton on June 6, 1944. However, Appellee's own case refutes the possibility of any such conversation. Newton's recollection of the conversation which occurred according to him on a specific date, is refuted by Gerety's testimony. It is rather peculiar that Newton did recall this one conversation when he was so vague and indefinite about meetings held by the executive committee. However, disregarding Newton's testimony relative to this

conversation and Gerety's testimony contradicting this testimony, Appellee has shown that such a conversation could not have occurred under the testimony of their own witness Hugh Darling. It is undisputed that DARLING had been a director of the corporation and was the representative of the Cruickshank Company and was the person with whom all negotiations were made concerning the purchase of the sprinkler contract. Darling's testimony is that there was no offer ever made to the Abbot Kinney Company on or about June 6, 1944, to sell the sprinkler contract for \$10,000.00 or for any other sum [R. 399]. Darling testified that from about 1937 to 1944 he brought up the matter of the Abbot Kinney Company making payments on the contract [R. 386]. The contract was never offered at that time to the Abbot Kinney Company by the Cruickshank Company [R. 402]. He did offer the sprinkler contract in 1943 to the Davises for \$10,000.00. The contract had been offered to Williams, Halper and Phillips at prices ranging from \$25,000 to \$50,000 [R. 392]. From 1943 down to the date of the purchase of the contract, the only time \$10,000.00 was ever mentioned was when Gerety offered \$10,000.00 for the contract in June, 1944. This offer, a subsequent offer of \$12,500.00 and an offer of \$15,000.00 was made by Gerety and Brown and the only price ever mentioned in 1944 other than the above offers, was the price of \$15,000.00 which was finally paid by Gerety and Brown [R. 399].

Appellants firmly believe that Newton's testimony relative to anything that occurred in June, 1944, with reference to the above subject was just a figment of Newton's imagination. That was very apparent from his indefiniteness under cross-examination.

On page 54 of Appellee's Brief, the contention is made that Gerety participated in and was part of the conspiracy. There being no showing (1) that the Harrahs were interested in the sprinkler contract at that time, or (2) that Brown and Gerety had any fiduciary relationship to the Abbot Kinney Company at that time, their negotiations for the purchase of the contract could not be a part of any conspiracy. On page 55 of Appellee's Brief, cases are cited relative to officers and directors acquiring claims against an insolvent corporation. The answer to these contentions is that there was *no showing that the corporation was insolvent* and there has been *no attempt on the part of the Appellee to show that Gerety was an officer of the corporation within the purview of the cases cited by Appellee.* In fact, Appellee has failed to comment on any of the cases cited by Appellants showing Gerety was not an officer of the corporation. As admitted by Appellants, John Harrah, because of the fact that he was an officer of the corporation, held a fiduciary relationship with the corporation and the cases cited on page 55 of Appellee's Brief would be applicable to John Harrah as a director of the corporation, but it is to be noted that these cases, as stated in Appellants' Opening Brief, applied to directors and officers of the corporation and *not to a person in Gerety's position.*

There is no need to further comment on the position of Gerety and his duties. His relation to the corporation is fully set forth commencing on page 35 of Appellants' Opening Brief.

On page 58 of the Appellee's Brief, the statement is made that Brown cannot profit from violation of the fiduciary obligation owed by John Harrah or Gerety and

cases supporting such statement are cited by Appellee. The law in the cases cited by Appellee is good, but before these cases would be applicable to the instant case, it would have to show first, that Gerety at the time of the purchase of the contract owed a fiduciary relationship to the Abbot Kinney Company and, second, that John Harrah was at that time one of the so-called conspirators who were attempting to acquire the contract. The facts do not warrant the conclusions upon which Appellee bases its arguments.

Reply to Appellee's Argument re Court's Right to Modify Findings.

In answer to Appellee's Point No. IX, in which it is stated the court did not err in modifying the findings of the referee, the statement is made that the court had the right to hold that the Abbot Kinney Company could, on June 6, 1944, have purchased the contract for \$10,000.00. All that need be stated on this point is that the testimony of the witness, Hugh Darling, produced by Appellee, is that there was *no offer in the year 1944 to sell the contract to anyone* (he also testified he never offered the contract to the Abbot Kinney Company in 1944) *for \$10,000.00* and that although negotiations had been conducted with a concessionaire by the name of Phillips and with Halper, who offered \$12,500.00 for the contract, the only offer ever made for the purchase of the contract that was accepted by Cruickshank Company was the offer of \$15,000.00.

In the petition for an order to show cause [R. 22], the Appellee offered to do equity in connection with the acquiring of the sprinkler contract. It is to be noted

that Appellee did not appeal from the findings of fact and conclusions of law of the referee in the instant case. However, the Court of its own motion determined that the amount to be received by the Appellants for the sprinkler contract was not to be the purchase price, to wit, \$15,000.00, but the sum of \$10,000.00. As stated in Appellants' Opening Brief, there are no facts that warrant the court to reduce the amount to be paid the Appellants from \$15,000.00 to \$10,000.00, and there is no law that justifies the court in making any such reduction.

The law is well settled that when an officer acquires a claim against a corporation under circumstances which render it inequitable for him so to do and where the corporation is *insolvent*, the director is precluded from recovering more than he paid for the claim. Without arguing the facts of the instant case, it is clear that there is no law that would justify the court in penalizing the purchasers of a claim and indirectly awarding punitive damages. See *Bonney v. Tilley*, 109 Cal. 346, and *Phillips v. Sanger Lbr. Co.*, 130 Cal. 431, in both of which cases it has been settled that the director of a corporation is entitled to a restoration of the consideration or moneys paid by the director in acquiring an obligation against the corporation where the circumstances were such that the director had no right to make a profit out of the particular transaction. In the case of *Bonney v. Tilley*, *supra*, it is even held that the officer of a corporation acquiring a claim against the corporation is not only entitled to receive back the consideration paid by him for the claim but is also entitled to interest.

Appellee has cited no law which would in any manner substantiate its contention that the District Court had

the right to make any judgment holding the purchasers of claims against a corporation must turn over these obligations to the corporation at less than the purchase price of the same, irrespective of any alleged fraud or inequities in connection with the transaction.

Summary and Conclusion.

Appellants maintain, and have shown in their Briefs herein, that the order appealed from is void and should be annulled and set aside for the following reasons:

(a) There was no jurisdiction ever invoked to sustain said proceedings, because:

(1) The involuntary petition was *not signed or filed by any qualified unsecured creditors.*

(2) *No act of bankruptcy* was stated therein.

(b) The matter tried was not the subject matter of a summary proceeding, and the debtor could not institute the same.

(c) The alleged debtor was *never adjudicated a bankrupt.*

(d) The petition was *defective and not signed or filed by any qualified creditors and conferred no jurisdiction;* accordingly, all proceedings taken thereunder were void and of no effect.

(e) The dismissal of the involuntary petition carried with it everything ancillary thereunder.

(f) Such proceedings were in violation of the stipulation of the parties, approved by the Court, and no such proceedings should have been allowed until, if and after, there had been an adjudication.

(g) There was error in refusing a creditor the right to intervene and in denying his motion to dismiss.

(h) The evidence does not sustain the findings.

(i) The Court also erred in reducing, on its own motion, and in the absence of appeal, the referee's finding with reference to the repayment of \$15,000.00.

We respectfully submit that the order (of May 27, 1946) appealed from should be reversed and set aside.

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